

Commercial property: Market analysis and potential interventions

Supplementary note in the light of the Covid-19 crisis

Introduction

In 2019, the Welsh Government commissioned SQW to carry out a review of the Welsh commercial property market, identifying a range of interventions that could help to support the strategy set out in the *Economic Action Plan*.

The final report was completed shortly before the Covid-19 crisis led to major disruption to all aspects of economic life. The UK and Welsh Governments responded quickly to the need to support businesses and jobs during the crisis, and over the next 12-18 months, 'economic recovery' will be a central focus of policy, probably with continued high levels of public sector intervention.

This will have implications for the Welsh Government's commercial property activities. While the longer term picture is uncertain, this note sets out early thoughts on the potential impact of the crisis on demand, supply and intervention, which can be developed further over the coming months.

The economic outlook

- **Overall, the economy faces a major contraction this year.** The Office for Budget Responsibility's 'reference scenario' anticipates a 13% fall in UK GDP in 2020 (although forecasts vary substantially)¹. Looking to the future, the OBR anticipates a sharp rebound in 2021 – but there is a strong risk that recovery could be shallower and more protracted, with unemployment likely to remain relatively high beyond a return to output growth².
- **Sectors that generate demand for 'B-class' space are likely to be somewhat more resilient than the economy overall**, at least in the short term. The brunt of the immediate impact has been borne by 'shutdown' sectors, such as hospitality, tourism, leisure and arts and non-food retail, with more modest losses of output in traditionally office-based sectors such as finance and insurance, professional services and IT.
- **However, the scale of the downturn could lead to structural changes in the Welsh economy.** For now, job losses have been mitigated by the Coronavirus Job Retention Scheme and other measures (although the overall claimant count in Wales rose by 73% between March and April). But likely redundancies in the aviation sector³ suggest the potential for longer-term changes, including in 'higher value' industries. Set against that, the crisis could point to

opportunities for long-term growth in health and medical technologies (in which Wales has a strong presence) and online and digital services.

- **There could be greater demand for local production and shorter supply chains** to support economic resilience. This has been widely discussed, although there is limited evidence so far – and the net effect on the Welsh economy (given the importance of export industries) needs to be considered carefully.

Potential impacts on the office market

- **Experience of homeworking could accelerate a trend towards more remote working and flexible use of office space.** Lambert Smith Hampton's survey of office workers during lockdown indicated that while the majority of those now obliged to work at home had either never or rarely done so, most envisaged working at home for at least a couple of days per week once the crisis had passed⁴. At the same time, where productivity has been maintained despite (or perhaps because of) greater remote working, employers may be more willing to embrace flexibility in the future. However, social interaction and networking remains important – perhaps reinforcing a trend for fixed, traditional workplaces to act as more flexible 'hubs' in the future, combined with both home and local working.
- **There could be opportunities for flexible workplaces, closer to home.** The *Market Analysis and Potential Interventions* report noted widespread high demand for flexible managed workspace, even in locations where conventional office demand was very weak. A social trend towards shorter commutes and a changed balance between home and office working could lead to greater demand for accommodation in suburban and smaller town locations – potentially helping to support the Welsh Government's objectives of "*better jobs, closer to home*", as well as environmental sustainability. Oxford Innovation, a major provider of innovation centre space in England, reports a rising volume of enquiries during the latter stages of lockdown, both from smaller businesses and major corporates looking to establish more local hubs, perhaps reflecting demand for more 'decentralised' accommodation.
- **There has been limited analysis of local office markets since the start of the crisis**, and some of the potential trends that have been recently discussed have yet to be borne out in the data. In **Cardiff**, Savills remain bullish on market prospects, noting high demand and limited supply for Grade A offices: "*As we move into 2021, demand will likely outstrip suitable office supply, demonstrating the need for speculative development in Cardiff*"⁵. However, this will obviously be dependent on the wider economic consequences of the downturn and the length of the recovery process. Elsewhere, further research is needed.

Potential impacts on the industrial market

- **Industrial demand may be less impacted by the crisis itself:** homeworking is not generally an option, and much of the production sector has continued working throughout the lockdown, although this will depend upon the type of production process and the opportunities to maintain safe, working conditions. Savills reports a generally neutral impact on industrial

demand⁶ (and it should be noted that any fall in demand should be seen in the context of very constrained industrial supply).

- **Over the longer term, ‘reshoring’ could impact positively on demand.** This could include a desire by manufacturers to build in resilience across the supply chain by ensuring a wider distribution of productive capacity, which could benefit Wales given its existing manufacturing strengths.
- **However, disruption and uncertainty could further reduce the prospects of a growth in supply without intervention.** The *Market Analysis and Potential Interventions* report noted that across much of Wales, the delivery of new industrial stock is unviable, despite evidence of strong demand and, in most cases, constrained supply. Further uncertainty is likely to exacerbate this.

Potential implications for Welsh Government intervention

- **Overall, the central rationale for Welsh Government intervention in the commercial property market remains strong, and is likely to be reinforced by the current crisis,** especially in conditions of widespread uncertainty. However, as the economy moves towards recovery, there will need to be a greater role for the public sector than might have been envisaged when the *Market Analysis and Potential Interventions* report was prepared, including through direct support for employment and perhaps increased state aid to industry. The provision of appropriate commercial property will form an important part of the mix and will need to be reflected in this.
- **There could be fundamental changes to office demand,** both in the type of floorspace and preferred locations, which will need to be thought through. Some of these are foreshadowed in the *Market Analysis and Potential Interventions* report, which proposes a focus on a small number of locations and highlights rising demand for flexible workspace.
- **There could be a reinforced role for commercial property intervention to support economic diversification.** In the short term, those parts of Wales that are highly reliant on the visitor economy (such as Gwynedd and Anglesey) will see a very sharp contraction. The tourism sector will ultimately return as the crisis passes, but ensuring capacity for a more diverse range of employment opportunities is likely to be important as part of a longer term resilience strategy.

¹ GDP scenarios range for 2020 range from -6.5% (IMF) to -14% (Bank of England). PwC (4 June), *Covid-19 UK Economic Update* (<https://www.pwc.co.uk/services/economics-policy/insights/uk-economic-update-covid-19.html>)

² Bevan Foundation (May 2020), *Where Next for the Welsh Economy?*, p.3 (<https://www.bevanfoundation.org/wp-content/uploads/2020/05/Economy-Briefing-Final.pdf>)

³ For example, possible redundancies have been announced at Airbus (Deeside), GE Aviation (Nantgarw), British Airways (Blackwood) and Safran (Cwmbran)

⁴ Lambert Smith Hampton (20 May 2020), *Rethinking your Office Requirement?* (<https://www.lsh.co.uk/covid-19/rethinking-your-office-requirement?listing=true>)

⁵ Savills (2 June 2020), *Spotlight: Cardiff Offices* (https://www.savills.co.uk/research_articles/229130/300445-0)

⁶ Savills Research (May 2020), *The impact of Covid-19 on real estate* (<https://www.savills.com/impacts/market-trends/the-impact-of-covid-19-on-real-estate.html>)